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Central Intelligence Agency

Washington, D. C. 20505

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DIRECTORATE OF INTELLIGENCE

2 May 1984

ARAB EFFORTS TO CURTAIL TRADE WITH IRAN: PROBLEMS AND PROSPECTS

Summary

Saudi Arabia and Kuwait, at Iraq's behest, are leading an Arab League diplomatic campaign to curtail Tehran's warmaking capability by restraining international trade with Iran. The Arabs, however, apparently have not mapped out a clear strategy for attaining their goals. They appear to be relying almost entirely on moral suasion rather than concrete measures such as trade sanctions or oil boycotts against countries that continue to deal with Iran. This apparent half-heartedness has led Japan--Iran's major trading partner--to conclude that the Arab League campaign is a largely cosmetic effort designed to reassure Iraq of Arab support rather than to seriously crimp Tehran's war effort. [redacted] 25X1

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This paper was prepared by [redacted] *Office of Near Eastern and South Asian Analysis, with contributions from the Offices of Global Issues, European Analysis, East Asian Analysis, and the Arab-Israeli Division of NESA. Comments and queries are welcome and may be directed to the Chief, Persian Gulf Division, NESA,* [redacted] 25X1
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Even if the Persian Gulf Arabs earnestly attempt to restrain Iran's trade, their prospects for success would not be promising. The Saudis and other Gulf Arabs lack effective leverage with most of Iran's trading partners except for a few countries that are dependent on them for financial aid, oil supplies, or their commercial markets. Military supplies of the kind needed by Tehran are plentiful and difficult to monitor. Moreover, non-military trade is too lucrative to forego for most OECD countries, and Iran is willing to cut its oil prices to maintain its market share. Finally, Saudi Arabia and Kuwait traditionally avoid antagonizing powerful neighbors like Iran and are unlikely to escalate their efforts to a level that risks retaliation from Tehran. This guarantees that their efforts will be largely ineffectual. [redacted] 25X1 [redacted] 25X1

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The Arab League Campaign

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During a meeting in Baghdad in March, Arab League foreign ministers formed a special committee, consisting of Saudi Arabia, Kuwait, Jordan, Tunisia, North Yemen, Morocco, and Iraq, to begin a "serious" campaign to stop the flow of arms and oil revenues into Iran. Of the Arab League committee members, only Saudi Arabia and--to a lesser degree--Kuwait have the immense oil resources, financial wealth, and lucrative commercial markets that could be used to bring pressure on Iran's trading partners. [redacted] 25X1

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Iran's Sources of Arms

The revolutionary Islamic government of Ayatollah Khomeini has built its military strategy around lightly armed infantry units, lessening its need for the sophisticated--and hard to acquire--tanks and aircraft purchased by the Shah. [redacted] 25X1 25X1

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[redacted] given its reliance on massed infantry, Iran's most pressing needs are for artillery, small arms, and ammunition. These items are available world-wide, and a total arms embargo of Iran is virtually impossible. [redacted]

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Arms deliveries to Iran from all sources since the war began in September 1980 are estimated at $2.9 billion. Communist countries have been the largest suppliers, with deliveries worth approximately $1.4 billion. North Korea has been Iran's most important source of military equipment, ranging from tanks to small arms and ammunition. [redacted]

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China signed military sales agreements with Iran in 1983 worth $445 million that, when delivered, would make Beijing the second largest supplier of arms to Tehran. [redacted]

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[redacted] The USSR, on the other hand, has signed only two minor arms agreements with Iran--in 1981 and 1982--since Ayatollah Khomeini came to power in 1979. [redacted]

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[redacted]

Libya presently is Iran's second largest arms supplier. [redacted]

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West European countries have provided Tehran with spare parts, ammunition, and small arms worth approximately $550 million since September 1980. [redacted]

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Non-Military Trade and Oil Purchases

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The OECD countries (most Western European countries, Japan, Canada, and the US) are Iran's major trading partners for non-military items, as well as the major purchasers of Iranian oil. Iran's non-military imports consist primarily of food (approximately 6 million tons of grains and rice in 1983), construction and electric power generating equipment, machinery, steel, chemicals, and plastics. Thailand provides virtually all of Iran's rice imports; grains are readily available from a variety of countries. [redacted]

[redacted] Virtually all Iranian oil destined for the OECD countries is actually purchased by private oil or trading companies rather than through government-to-government contracts, and much of it is traded on the world spot market for oil. US companies bought an average of 101,000 barrels per day of Iranian oil this way in 1983, providing Tehran with over $1 billion. [redacted]

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Japan is Iran's major trading partner. West Germany exceeds Japan in value of goods sold, but purchases relatively little oil to balance the bilateral trade. Conversely, Italy is Iran's second largest buyer of oil, but, unlike West Germany, runs a large negative trade balance. The US is the third largest purchaser of Iranian oil, but exports relatively little to Iran. 25X1

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Arab Economic Leverage

25X1 The Saudis and Kuwaitis so far have limited themselves to moral suasion in their effort to convince most countries to restrain trade with Iran, but few states are likely to forego such profitable commerce unless the Gulf Arabs use economic leverage. In theory, the Gulf Arabs could apply significant economic pressure on those developed and developing countries dependent on them for oil, financial aid, sales markets, or development business such as construction contracts. In practical terms, however, such pressure would be difficult to apply except in a few cases. Moreover, Saudi Arabia and the Gulf Arabs have minimal economic leverage over Iran's Communist arms suppliers, 25X1

25X1 The OECD countries probably believe--and we agree--that the present situation is not so critical to the Saudis or the Kuwaitis that they would be willing to take concrete steps such as cancelling major contracts or stopping oil sales. In contrast to 1973 and the years immediately following, the current soft oil market has greatly blunted the threat to Western nations of

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25X1 economic pressure from the Gulf Arab oil producers. In addition, the Gulf Arabs now depend heavily on the OECD countries for domestic, economic, and industrial development. Most Western governments can deflect Saudi or Kuwaiti demarches on restraining trade with Iran by arguing that it is controlled by private companies over which they have no influence. [redacted] 25X1

Several countries, however, could be vulnerable to Saudi pressure if Riyadh decided to flex its economic muscle. South Korea received 31 percent of its oil from Saudi Arabia in 1983, and another 11 percent from Kuwait. In addition, South Korean construction firms do an estimated $5 billion business annually in Saudi Arabia, providing crucial foreign exchange for Seoul and employment for Korean nationals. Riyadh provides Taiwan with approximately 45 percent of its crude oil and is one of the few countries maintaining full diplomatic relations with Taipei. In addition, the Saudis have provided, or pledged, $300 million in development loans to Taiwan over the past few years. [redacted] 25X1

25X1 Riyadh has made both countries aware of its displeasure at reports that they are supporting Tehran's war effort. [redacted] the Saudis informed Seoul in early March that Riyadh might be forced to review bilateral relations because of press reports that the South Koreans are selling military equipment to Iran. In April, the Saudis made known to Taipei their concerns that Taiwanese might be contracting to perform aircraft maintenance work for Tehran. Both Seoul and Taipei recently have informed the US--and presumably the Saudis--that they will refrain from providing military assistance to Iran. Private South Korean companies, however, are still engaged in negotiations to sell arms to Iran. [redacted] 25X1 25X1

25X1 Japan, with no indigenous oil resources, depends heavily on the Gulf states for oil imports and is the OECD country most vulnerable to economic pressures by the Saudis or other Gulf Arabs. Last year, Japan received approximately 11 percent of its oil from Iran, but imported another 34 percent from Saudi Arabia and Kuwait. The Iraqis and the Kuwaitis have told Japanese officials and businessmen of their unhappiness over Tokyo's large oil purchases from Iran, but their messages have been diluted by contradictory signals from Saudi Arabia and other Gulf Arabs. [redacted] 25X1

25X1 [redacted] Tokyo has concluded from talks with the Saudis [redacted] that Riyadh believes: 25X1

- Arab economic sanctions against Japan could not be enforced.
- Japanese trade with Iran is so important to Tehran that Arab sanctions against Tokyo could provoke Iranian retaliation against the Gulf Arabs.
- Good Japanese-Iranian relations may be useful in moderating Iranian behavior or contribute to ending the Iran-Iraq war.

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[redacted] Tokyo has concluded that the Arabs are more interested in registering their complaints with Japan for the record than in seriously insisting that Japanese oil purchases from Iran be stopped or sharply curtailed. He commented that Japanese oil purchases are the responsibility of the private sector--a situation found in all OECD countries--and decisions are strictly governed by market factors. [redacted] the Arabs could easily assure a decrease in Japan's oil purchases from Iran by undercutting Tehran's prices by as little as five cents per barrel, particularly now when many Iranian oil contracts are up for annual renegotiation. [redacted] no Arab oil producer has approached them with an offer to replace Iranian supplies if Tokyo cuts its purchases from Tehran. [redacted] 25X1 25X1 25X1 25X1 25X1

Syria theoretically is vulnerable to Saudi and other Gulf Arab economic pressure, but it is a special case. A maverick on the Iran-Iraq war, Syrian President Hafiz Assad has broken ranks with most other Arabs by siding with Iran because of traditional Syrian-Iraqi political rivalry and Assad's personal hatred of Iraqi President Saddam Husayn. Syria's closure since 1982 of an Iraqi oil export pipeline to the Mediterranean has forced Saudi Arabia and the other Gulf Arab oil producers to spend billions of dollars subsidizing the Iraqi war effort. At the same time, Syria has received $530 million per year in Baghdad Pact subsidy payments from Saudi Arabia since 1979. Damascus regularly defies Riyadh's expressions of displeasure over Syria's support for the Iranian war effort and ignores Saudi requests to reopen the Iraqi pipeline. The Saudis, however, have refused to use their aid as leverage against Damascus. They fear that Syria would retaliate against any aid cutoff with acts of terrorism, and they have a pan-Arab sense of responsibility to support Syria as a front-line state confronting Israel. [redacted] 25X1 25X1

[redacted] 25X1 25X1

Libya, although an Arab country, supports the Iranian war effort for revolutionary and ideological reasons. Tripoli's oil wealth makes Libya immune to Saudi economic pressure. Over the past few years, Colonel Qadhafi occasionally has altered his foreign policy to mend fences with the Arab moderates, but has never lessened his support for Iran as part of these efforts. [redacted] 25X1 25X1

Prospects and Implications

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The UAE oil minister has commented--and many analysts of the international petroleum market agree--that the Arab League foreign ministers undertook this campaign without an adequate understanding of the practical problems involved in attempting to curtail trade with a major oil supplier such as Iran. Oil is too vital to all modern economies, and too fungible a commodity on world markets, for its trade to be manipulated easily. [redacted] 25X1

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If the Arab League's campaign were only partly effective in curtailing Tehran's oil sales, it would put considerable downward pressure on Iranian oil prices and, at least temporarily, on Iranian revenues. For example, a 100,000 b/d drop in exports would cost Tehran about $1 billion per year. To accomplish this goal, however, the Gulf Arabs would have to be willing to risk a price war and destruction of OPEC's fragile cohesion on oil pricing and production because Iran would retaliate by cutting its oil prices to attract buyers, and increasing its exports to compensate for reduced prices. The current OPEC pricing and production policies were hammered out only with great effort by Saudi Arabia--against Iranian resistance--in 1983, and this probably is a major reason why the Saudis appear half-hearted about pushing the Arab League campaign with countries such as Japan. [redacted]

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The Arab League effort, moreover, is likely to have only a marginal impact on Iran's non-oil trade with OECD countries, and no significant effect on Iran's capability to import arms. The military equipment provided by countries such as South Korea can be replaced, albeit perhaps with some delays or at higher prices. [redacted]

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